

Master Document – Audit Program

Activity Code 19404		Compliance Audit CAS 404
Version 5.0, dated April 2004		
B-1	Planning Considerations	
Purpose and Scope		
<p>1. The purpose of CAS compliance auditing is to determine if the contractor's policies, procedures, and practices used to estimate, accumulate, and report costs on Government contracts and subcontracts comply with the requirements of CAS. CAS 404 requires that, for purposes of cost measurement, contractors establish and adhere to policies with respect to capitalization of tangible assets which satisfy criteria set forth in CAS 404. It does not cover depreciation or disposition of fixed assets, which is covered by CAS 409. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 404 criteria (48 CFR 9904.404). Because of the interrelationship of the two standards and to achieve efficiency, CAS 404 and CAS 409 should be audited concurrently.</p>		
<p>2. The scope of this audit should generally be limited to the contractor's current fiscal year (CCFY). Some limited testing of prior years' unaudited transactions may be appropriate to assure that no system changes were made or noncompliances exist. For efficiency, CAS compliance testing, if possible, should be performed concurrently with tests for compliance with FAR and contract terms.</p>		
<p>3. This program is intended to provide for the proper planning, performance, and reporting on the contractor's compliance with CAS 404. The audit steps in the program should reflect a documented understanding between the auditor, the technical specialist, as applicable, and the supervisor as to the scope required to comply in an efficient and effective manner with generally accepted auditing standards and DCAA objectives. The program steps are intended as general guidance and should be tailored as determined by audit risk.</p>		
Other Planning Considerations		
<p>1. Before beginning any CAS compliance audit, the auditor should first determine whether the contractor is subject to the CAS coverage. If the standard is not applicable to the contractor or noncompliance with the standard overall has no significant impact on Government contract costs, there is no need to test whether the contractor is complying with the standard. The decision to not test for CAS compliance should be documented (see CAM 8-305 and DoD CAS Working Group Guidance Paper 76-7).</p>		
<p>2. Materiality (see 48 CFR 9903.305) and audit risk assessment (including Internal Control Audit Planning Summary (ICAPS) for major contractors, Survey of Contractor's Organization, Accounting System, and System of Internal Controls (ICO) for</p>		

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nonmajors, and historical CAS problems) are integral parts of the planning process and should be considered in developing the extent and frequency of CAS compliance tests.
3. Once it is determined that the standard is applicable and material to the Government, the auditor should assess which provisions of the standard are significant to the contractor; the extent reliance may be placed on the contractor's system of internal controls to ensure compliance; and the results of other relevant audits (e.g., results of prior compliance audits, Disclosure Statement revisions, etc.). The decision to not test whether the contractor is complying with specific provisions of the standard should be documented.

B-1	Preliminary Steps	WP Reference
Version 5.0, dated April 2004		
1. Research and Planning		
a.	Read and become familiar with the criteria in CAS 404, CAM 8-404, and any recent Headquarters guidance not incorporated in CAM. Identify any changes in the CAS 404 standard since the last examination.	
b.	Evaluate Part V of the contractor's Disclosure Statement to become familiar with the disclosed accounting practices. Determine if the contractor's disclosed practices have changed since the last CAS 404 compliance audit. If changes have occurred, document file and adjust audit scope accordingly.	
c.	Determine whether the total value of the contractor's tangible capital assets are material. Possible sources include the contractor's financial statements, general ledger balances of plant, property and equipment, fixed asset subsidiary ledgers, depreciation schedules, CAS 414 Form CASB-CMF, and capital acquisition plans or budgets. Consider contract mix (Government vs. commercial) when determining costs subject to this standard are material.	
d.	Before discontinuing the audit due to insignificant dollars related to the capitalization of tangible assets, consider whether the contractor may be expensing assets that should be capitalized. Assets may be expensed in accounts, such as, Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc. If the audit is discontinued due to insignificant dollars, document the permanent files and appropriate requirements plan working papers in accordance with CAM 8-305.2.	

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e. Examine information included in FAO files to determine what data are available, what audit steps were done in the past, and the results from those steps. This will identify areas of high risk and/or areas where limited or no compliance testing is necessary. Files to evaluate include:	
(1) Prior audit work packages (such as, prior CAS compliance audits, Disclosure Statement, and incurred cost audits)	
(2) FAO permanent files (including ICAPS, ICQ, ICM-ACTG, and MAARs Control Log). (Applicable MAARs 1, 3, 5, 15, and 16.)	
f. Coordinate with FAO technical specialist and/or regional specialist on matters of interpretation and policy.	
g. Discuss the planned compliance audit with the administrative contracting officer and, if appropriate, other customers to identify, understand, and document any concerns they may have or areas, which should be evaluated.	
2. Entrance Conference and Preparation	
a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on obtaining an understanding of the contractor's capitalization process and its internal control structure. Request the contractor to explain the following:	
(1) Its capitalization system and process and identify relevant written policies and procedures	
(2) If considered necessary, request a "walk through" of the capitalization system	
(3) Any changes, or planned changes, to policies and procedures related to CAS 404 since the last DCAA examination	
(4) Any business combinations since last DCAA CAS 404 examination	
(5) Any corrective actions related to previously identified noncompliances.	
(6) Dollar values of:	
(a) Self-constructed assets placed in service since prior examination;	
(b) Assets acquired through less than arm's length	

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transactions; and	
(c) Asset accountability units.	
If the dollars are significant, consider separate transaction testing of these assets.	
(7) Capital budget variance analysis and explanation of significant variances. (If the capitalized amount is significantly less than the capital budget, assets may have been expensed when they should have been capitalized.)	
(8) Identify new facilities and major renovations.	
Consider separate transaction testing for initial complement of low cost equipment and betterments and improvements.	
b. If reliance is to be placed on the work of others, the file should contain the required documentation. (see CAM 4-1000).	
3. Risk Assessment	
a. Gain an understanding of the contractor's internal control structure by reviewing relevant ICAPS or ICQ (whichever is applicable). Identify any known deficiencies. Assess the control risk.	
b. If the contractor is classified as non-major (where ICAPS have not been completed) and if the evidential matter to be obtained during the audit is highly dependent on computerized information systems, document on working paper B-2, the audit work performed that supports reliance on the computer-based evidential matter. Specifically, document or reference one or more of the following in working paper B-2:	
(1.)The audit assignment(s) where the reliability of the data was sufficiently established in other DCAA audits,	
(2.)The procedures/tests that will be performed in this audit to evaluate the incurred costs that will also support reliance on the evidential matter, and/or	
(3.)The tests that will be performed in this audit that will be specifically designed to test the reliability of the computer based data.	
When sufficient work is not performed to determine reliability (i.e., reduce audit risk to an acceptable level), qualify the audit report in accordance with CAM 10-210.4 and 10-807.3.	
c. Document assessment of the contractor's internal control structure relative to this standard (control environment, accounting system,	

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and relevant policies, procedures, and practices) to assure compliance with laws and regulations.	
d. Identify accounts where the contractor may be expensing assets that should be capitalized. These accounts could include Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc.	
e. Determine high-risk areas by performing the following:	
(1) Determine the dollar amounts in the various accounts.	
(2) Perform comparative analysis of the identified accounts to determine if significant changes may have occurred (MAAR 15).	
(3) Determine provisions of the standard that are material.	
f. In planning and performing the examination, review the fraud risk indicators in CAM Figure 4-7-3 for applicability to this audit. Document in working paper B any identified fraud risk indicators and your response/actions to those identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed. If no risk indicators are identified, document this in working paper B.	
g. From the information gathered in the preceding steps and using the materiality criteria in 48 CFR 9903.305, assess the audit risk and determine the scope of audit and extent of compliance testing to be performed.	
h. Update the information in the permanent files as needed.	

C-1	Written Policy	WP Reference
Version 5.0, dated April 2004		
1.	Determine that the contractor has a written capitalization policy (CAS 404.40(a)).	
2.	Determine that the written policy designates economic and physical characteristics as follows (CAS 404.40(b)(1):	
a.	The <u>minimum service life</u> criterion, which shall not exceed <u>2 years</u> , but which may be a shorter period.	
b.	The <u>minimum acquisition cost</u> criterion, which shall not exceed <u>\$5,000</u> , but which may be a smaller amount.	
c.	Specific characteristics which are pertinent to its capitalization policy decisions (e.g., class of asset, physical size, identifiability and controllability, the extent of integration or independence of	

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constituent units). (CAS 404.40(b)(2))	
d. Identification of asset accountability units to the maximum extent practical. The contractor's policy should consider (CAS 404.40(b)(3):	
(1) Whether the component represents a significant portion of the total unit's cost (materiality);	
(2) Whether the component is divisible from the total unit;	
(3) Whether the component is subject to separate valuation.	
e. Higher than \$5,000 minimum dollar limitations may be designated for original complement of low-cost equipment and for betterments and improvements if such higher limitations are reasonable in the contractor's circumstances (CAS 404.40(b)(4)).	

D-1	Acquisition Costs	WP Reference
Version 5.0, dated April 2004		
1.	Evaluate significant items included in expense accounts, such as, Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc. to determine that tangible assets which meet either the criteria in Steps 2a and 2b in W/P C-1 or the criterion in 2e in W/P C-1 are capitalized.	
2.	Evaluate significant items included in expense accounts, such as Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc. to determine that costs incurred subsequent to the acquisition of tangible capital assets which result in either extending the life or increasing the productivity of that asset (e.g., betterments and improvements) and which meet the contractor's established criteria for capitalization are capitalized with appropriate accounting for replaced asset accountability units. (However, costs incurred for repairs and maintenance to a tangible capital asset which either restore the asset to, or maintain it at, its normal or expected service life or production capacity shall be treated as costs of the current period. (CAS 404.40(d))	
3.	Compare capitalized amounts of significant asset items to invoices, purchase orders, or sales contract to determine that the purchase price has been adjusted to the extent practical by premiums and extra charges paid or discounts and credits received which properly reflect an adjustment in the purchase price (CAS 404.50(a)(1)).	
4.	Determine that the purchase price is the consideration given in exchange for an asset and is determined by cash paid or amount	

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<p>equivalent to what would be the cash price basis. If the amount is not available, determine that the current value of the consideration given in exchange is reasonable (e.g., market value or fair value). [Note: investment credit need not be deducted from the purchase price of a tangible capital asset in determining the acquisition cost of that asset] Refer to CAS 404.50(a)(1)(i) and CAM 8-404.1 for details and examples.</p>	
<p>5. Determine that donated assets, which at the time of receipt, meet the contractor's criteria for capitalization shall be capitalized at their fair value at that time (CAS 404.50(a)(1)(ii).</p>	
<p>6. Determine that all costs necessary to prepare the asset for use including the cost of placing the asset in location and bringing it to a condition for normal or expected use are capitalized, such as initial inspection and testing, installation, and similar expenses where material in amount. However, materiality should be considered in deciding whether preparatory costs shall be capitalized. (CAS 404.50(a)(2)).</p>	
<p>7. Determine if contractor capitalizes sales or use taxes or other collateral costs of acquiring tangible capital assets. If the contractor does capitalize these costs, determine if the contractor follows this practice on a consistent basis. (Note: CAS 404 permits, but does not specifically require, the capitalization of sales or use taxes or other collateral costs of acquiring tangible capital assets.)</p>	

E-1	Self Constructed Assets	WP Reference
Version 5.0, dated April 2004		
<i>If the contractor does not have significant amount of self-constructed assets, do not perform the steps under this section</i>		
	<p>1. Determine that tangible capital assets constructed or fabricated by a contractor for its own use are capitalized at amounts which include all indirect costs properly allocable to such assets. This includes G&A expenses and cost of money when such expenses are identifiable with the constructed asset and are material in amount (CAS 404.50(b)).</p>	
	<p>2. Determine that constructed tangible capital assets which are identical with or similar to the contractor's normal product receive an appropriate share of all indirect cost including G&A expenses and cost of money. Constructed assets which are not similar to the contractor's normal products bear only those G&A expenses specifically identifiable with the asset and material in amount.</p>	

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F-1	Less Than Arm's Length Transaction	WP Reference
Version 5.0, dated April 2004		
1.	Determine if previously used tangible capital assets that were acquired by purchase or donation were obtained in an arm's length transaction.	
2.	If the acquiring transaction is not an arm's length transaction, determine if the contractor limited the capitalized acquisition cost of the asset to the capitalized cost of the asset in the hands of the owner who last acquired the asset through an arm's length transaction, reduced by depreciation charges from date of that acquisition to date of gift or sale (CAS 404.50(c)).	

G-1	Capitalization – Purchase Method	WP Reference
Version 5.0, dated April 2004		
<i>Note: This step applies only to external business combinations.</i>		
1.	Business Combinations taking place prior to the applicability date of the 15 April 1996 Revision to CAS 404.	
	Obtain the contractor's explanations on the accounting treatment of the acquired tangible capital assets. Evaluate asset ledger/report to determine that the asset is capitalized at an amount, which does not exceed the fair value at date of acquisition. Where the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method", the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess. Simply stated, the capitalized value can neither exceed the purchase price of the acquired company nor the fair value of the assets acquired.	
2.	Business Combinations taking place After the Applicability Date of the 15 April 1996 Revision to CAS 404.	
	Obtain the contractor's explanations on the accounting treatment of the acquired tangible capital assets and supporting documents and verify:	
a.	If the assets generated either depreciation expense or cost of money charges during the most recent cost accounting period prior to a business combination, determine that the assets are capitalized by the buyer at the net book value (no step-up, no step-down) of the assets as reported by the seller at the time of the transaction (CAS 404.50(d)(1)).	

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b. If the assets did not generate either depreciation or cost of money charges in the most recent year, determine that the assets are capitalized at an amount which does not exceed the fair value at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company, the value otherwise assignable to tangible capital assets shall be reduced by the excess (CAS 404.50(d)(2)).	
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H-1	Capitalization – Pooling of Interests Method	WP Reference
Version 5.0, dated April 2004		
<i>Note: This step applies only to external business combinations.</i>		
Determine that the asset is capitalized at the value established for financial accounting purposes for determining the cost of such assets; for instance, the combined assets, liabilities, and reserves are recorded at their existing carrying amounts. (CAS 404.50(e))		

I-1	Asset Accountability Units	WP Reference
Version 5.0, dated April 2004		
1. If the contractor uses asset accountability units, determine if the contractor identifies and separately capitalizes the assets at the time the assets are acquired (CAS 404.50(f)).		
2. Determine if the contractor removed units from the asset accounts when they are disposed of or if replaced, their replacements are capitalized (CAS 404.50(f)).		

A-1	Concluding Steps	WP Reference
Version 5.0, dated April 2004		
1. Summarize the results of audit.		
2. Discuss results with the supervisor or the FAO technical specialist. The auditor should only report those noncompliances which are considered material (see CAM 8-302.7). Coordinate significant or unusual issues with the CFAO, FAO Manager, and if applicable, with the CAC, CHOA, or GAC network (see CAM 8-302.4 - 8-302.6). Coordination should be both before and after discussion of results with		

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the contractor. The CFAO should be apprised of noncompliance matters at the earliest possible date. If a noncompliance is considered immaterial, recommend to the CFAO that the contractor be notified to reserve the Government's right should the cost impact become material (see FAR 30.602).	
3. Prepare draft audit report in accordance with CAM 10-807 (activity code 194XX) when no instances of noncompliances are found, or CAM 10-808 (activity code 19200) when instances of noncompliances are found. If scope was limited to certain provisions of standard, modify scope and opinion statements as necessary.	
4. Conduct an exit conference with the contractor in accordance with CAM 4-304.	
5. Finalize audit report incorporating the contractor's response and audit rejoinder, if applicable.	
6. Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented (e.g., by initials and date on the CD or working paper folder, etc.) and should include:	
a. The title, author, and keywords fields of the file properties in the audit report must be completed (for the audit report only) prior to final filing.	
b. Review the APPS exe file for size. APPS-generated executable files that are over 10 megabytes in size should be reviewed to ensure that the format and content justify the size. Supervisors are responsible for reviewing or designating someone to review these files for content and format.	
c. Review the APPS exe file for temporary files. These files can be recognized by the “~\$” or “~WRL” at the beginning of the file name. Once the APPS exe file is complete and there is NO ACTIVITY to be completed on any of the files contained within the exe file, any temporary files should be deleted so there are no unintentional versions of working papers and/or reports. NOTE: This should be done prior to invoking the Export/Archive Option in APPS.	
d. Once an audit report is signed, the electronic document should immediately be modified to indicate who signed it, and it should be password protected. The electronic file should then be renamed according to the convention “01 DCAA Report [RORG-ASSIGNMENT NO.] – Final.doc” and changed to a read-only file. Only this file should be stored, transmitted, or otherwise used for official purposes. For Memorandums the word “Report” would be replaced by “MFF” or “MFR” in the naming convention as appropriate.	

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e. When the audit report is transmitted electronically to the requestor, the transmission email should be saved as a txt file (this will ensure the attachments are not saved again). Saving delivery or read receipts is optional. If saved, the naming convention should distinguish them from transmittal emails.	
f. Once the report is signed, the signature page of the audit report must be scanned in accordance with Agency standard scanning instructions. For audit packages, the scanned signature page file should be named the same as the audit report (see above) with “-sig” added (i.e., 01 DCAA Report 01101-2002X10100389-Final-sig.pdf). There is no requirement to make the file a part of the APPS generated executable file and it must be included separately in the iRIMS folder. There is no need to scan the signature page of a Memorandum unless it is distributed outside of DCAA.	
g. Ensure an electronic copy of the final draft audit report containing the supervisory auditor’s initials and date, cross-referenced to the working papers, is included in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.	
h. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.	
i. Two complete sets of electronic working papers should be filed. One set (official) will be filed in iRIMS. A second set (backup) will be stored on removable media in the hard copy working paper folder. The new APPS naming convention (ex: 01701_2003A10100001_Archive_093003.exe) will be used for both. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.	
j. Verify using a separate machine, that electronic files stored on removable media are not corrupted and can be unarchived. Indicate the test was successful by placing tester initials and date prominently on the CD label.	
k. Securely enclose the “backup” set of electronic files (CD) and any “official” set of hard copy in the hard copy folder.	
l. File the “official” set of electronic files in iRIMS (see iRIMS User Guide).	
m. <u>Do Not File Sensitive Audits in iRIMS:</u> Sensitive audits include but are not limited to classified work, suspected irregular conduct,	

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hotline or DCAA Form 2000 related files. These audits should not be filed in iRIMS at this time. See CAM 4-407f for filing instructions.	
7. Update the permanent files, i.e., ICAPS or ICQ, and schedules for Mandatory Annual Audit Requirements (MAARs 1, 3, 5, and 16). <i>Ensure that a copy of DMIS Report Number CAS 3 entitled “CAS Compliance Testing (Activity Code 194XX)” is included in the permanent file after the assignment has been closed in DMIS.</i>	